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Honorable Frederick P. Corbit  
Chapter 9  
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UNITED STATES BANKRUPTCY COURT  
EASTERN DISTRICT OF WASHINGTON

In Re:

Case No. 17-02025-FPC9

KENNEWICK PUBLIC HOSPITAL  
DISTRICT,

Debtor.

KENNEWICK LIQUIDATION TRUST,

Adv. Proc. No. 17-80042-FPC9

Plaintiff,

v.

**THE UNIVERSITY OF PUGET  
SOUND'S SECOND MOTION  
FOR SUMMARY JUDGMENT**

THE UNIVERSITY OF PUGET  
SOUND, a Washington nonprofit  
corporation,

Defendant.

THE UNIVERSITY OF PUGET SOUND'S  
SECOND MOTION FOR SUMMARY  
JUDGMENT

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Adv. Case No. 17-80042-FPC9

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THE UNIVERSITY OF PUGET SOUND'S  
SECOND MOTION FOR SUMMARY  
JUDGMENT - iv

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## I. INTRODUCTION

The Court's Order on Summary Judgment determined that the Ayers' wills created a testamentary trust, that the Ayers Property is the corpus of that trust and, accordingly, that the Ayers Property is not "property of the debtor" in this Chapter 9 bankruptcy proceeding. (ECF No. 126, at 10, 11, ¶¶ 2, 9.) The Court further determined that "[t]he Trust was not terminated by the Settlement Agreement" and thus concluded that "[t]he Hospital holds the Ayers Property in trust, and the University's beneficial interest in the property continues to exist." (*Id.* at 11, 12, ¶¶ 10, 16-17.) It is undisputed that the University's beneficial interest extends to 50% of all proceeds derived from the Ayers Property, as the Court recognized in its Order. (*Id.* at 2, ¶ 5.)

Further, the parties have reached a resolution resolving many of the remaining claims. (ECF No. 137, submitted today.) Under the parties' stipulation, the University has agreed to dismiss its claim for a judicial lien; the Liquidation Trust has agreed to dismiss all claims seeking any avoidance or clawback of payments to the University under the settlement agreement with KPHD; and the parties resolved claims regarding the escrow transaction at issue in the amended complaint. As a result, all claims in the Liquidation Trust's amended complaint are resolved (three were dismissed by the Court's summary judgment ruling, ECF 126, and the remainder are addressed by today's

1 stipulation), including all fraudulent transfer, preference, and other avoidance  
2 claims.

3 The causes of action left for resolution are the remaining claims set forth in  
4 the University's counterclaims. This motion addresses the essential questions that  
5 remain for resolution: (a) the extent of KPHD's interest in the remaining trust  
6 property, in light of its failure to repay the full amount of the trust funds it  
7 misappropriated, and (b) how the trust property should be sold, so that the trust  
8 proceeds can be realized and distributed. In sum:

9 ➤ The law of trusts is crystal clear on the key point: when a trustee  
10 who is also a beneficiary wrongfully takes for itself trust funds, the other  
11 beneficiaries are granted an equitable charge against the trustee-beneficiary's  
12 remaining beneficial interest, which attaches at the time of the diversion of funds.  
13 Thus, as a matter of law, the University's interest in the remaining Ayers Property  
14 and its proceeds comprises the University's 50% beneficial interest plus the  
15 amount of the equitable charge necessary so that both parties ultimately receive  
16 their 50% share of the net proceeds. (*See* Sections III.A.1–2 below, at pp. 16–  
17 23.)

18 ➤ The Liquidation Trust's response is apparently the same as its  
19 response to the prior motion, which determined that the trust continues to exist  
20 and that the Ayers Property is trust property. The Liquidation Trust asserts that

1 the settlement agreement cuts off the University's trust rights to the equitable  
2 charge, and thereby allows KPHD (and now its successor, the Liquidation Trust)  
3 to take 50% of the remaining trust proceeds even though that results in a major  
4 windfall to KPHD and is contrary to the law of trusts. This argument has even  
5 less merit in this context: not only does the settlement agreement not release  
6 these rights, it expressly confirms and reiterates them. (*See* Sections III.A.3–6  
7 below, at pp. 23–38.)

8       ➤ Finally, there is the question of how the trust property should be  
9 sold. The University had asked the Court to approve the closing of the documents  
10 put in escrow by KPHD and the University before KPHD initiated this  
11 bankruptcy proceeding (the escrow transaction at issue); that had been an open  
12 issue, and the Court's Plan Confirmation Order provides that how the Ayers  
13 Property should be transferred must be determined in this adversary case. But, in  
14 violation of this order and without notice to the University or the Court, KPHD  
15 and the Liquidation Trust agreed to and completed last year a transfer of the  
16 remaining Ayers Property to the Liquidation Trust. As a result, the escrow  
17 transaction is moot—it simply cannot happen now (and as a result, the University  
18 has agreed to the disposition of this claim in the partial settlement stipulation,  
19 (ECF No. 137, at ¶ 1(a)). But that does not mean that the remaining Ayers  
20 Property cannot or should not be transferred in accordance with the process and

1 procedure called for by the Amendment—that remains an open issue. We submit  
2 that the Court should order a conveyance of the trust property in accordance with  
3 the amendment to the settlement agreement, which effects the intention of the  
4 Ayers’ wills and the trust those wills created. (*See* Section III.B.2 below, at  
5 pp. 40–41.)

6 We now turn to a statement of the relevant facts, and then to a detailed  
7 discussion of the apposite law demonstrating the University’s right to this relief.

## 8 II. FACTS

9 The complete facts are set forth in detail in the University’s first motion for  
10 summary judgment (ECF No. 101, at pp. 5–16) and the parties’ joint statement of  
11 material facts (ECF No. 114, hereafter the “JSF”), all of which are incorporated  
12 here by this reference as support for this motion. We recite below the agreed-  
13 upon and other undisputed facts most relevant to this motion.

### 14 A. The Ayers Property and the Parties’ Efforts to Increase Its Value

15 By their reciprocal wills J.R. and Alice Ayers made the University of Puget  
16 Sound (the “University”) and Kennewick Public Hospital District (“KPHD”) co-  
17 beneficiaries of thousands of acres of property in Benton County, Washington  
18 (the “Ayers Property” or the “Property”). (JSF ¶¶ 1, 4.) The wills bequeathed  
19 legal title to the Ayers Property to KPHD, and mandated and directed that KPHD  
20

1 shall pay to the University one-half of all net proceeds from the Property and  
2 make an annual accounting to the University of all receipts and disbursements.<sup>1</sup>

3 In the 1990s, KPHD and the University began to explore the possibility of  
4 increasing their beneficial take from the Property by obtaining water rights to  
5 allow the irrigation of the Property. Toward this end KPHD applied in 1991 for a  
6 permit to draw surface water from the Columbia River for use on the Ayers  
7 Property. (JSF ¶ 42.) Both KPHD and the University understood that the  
8 purpose of the water-rights permit was to enhance the value of the Ayers Property  
9 for their mutual benefit. That is, any increased rents or other proceeds from the  
10 irrigated property would be shared equally.

11 This is particularly evident in correspondence advocating for the permit's  
12 issuance, in which KPHD enlisted the assistance of the University as an interested  
13 party. For example:

14 <sup>1</sup> Copies of the Ayers' wills are attached as Exhibits A and B to the Declaration of  
15 Sherry Mondou in Support of the University of Puget Sound's Motion for  
16 Approval of Transfer of Real Estate Held in Trust, Case No. 17-02025-9, ECF  
17 No. 208 (hereinafter "First Mondou Decl.".) The First Mondou Declaration is  
18 also attached to the University's Statement of Specific Material Facts in Support  
19 of its Motion for Summary Judgment (ECF No. 102) as Attachment 1.  
20

➤ In an August 12, 1998 letter to Benton County Commissioner Max Benitz, KPHD's agent and consultant, Timothy Reiersen, stated that the University "has indicated willingness to assist as well, with a letter explaining their interest to Ecology Director Fitzsimmons. *The University and KGH share income from the trust lands equally.*" (JSF ¶ 43 (emphasis added).) The letter was copied to KPHD's Administrator, its legal counsel, the University, and several State Representatives.

➤ At the request of Mr. Reiersen, and using language he provided, the University followed up in a letter to the Department of Ecology Director Fitzsimmons explaining: "We have been contacted by Kennewick General Hospital regarding a water right issue which, as it turns out, directly affects the University of Puget Sound. The University is a beneficiary of annual proceeds from an approximately 8,000 acre property in Benton County which was donated as a trust holding, dedicated to agricultural uses, for our mutual benefit. A portion of the property is planned for irrigated farming in order to realize significantly greater potential earning." (JSF ¶ 44.)

➤ KPHD's Administrator, Thomas Nielsen, subsequently wrote to State Representative Shirley Hankins, similarly explaining: "This land and the proceeds from the land, benefit not only Kennewick General Hospital, but also, one half of the proceeds go to the University of Puget Sound." (JSF ¶ 45.) This letter was copied to the Office of the Attorney General, the University, and others.

As a result, the Department of Ecology likewise understood "that this project would benefit both the Hospital and the University of Puget Sound." (JSF ¶ 46.) Accordingly, DOE's 2003 Report of Examination—a precursor to the issuance of the permit—states:

The Kennewick Public Hospital District (KPHD) was willed approximately 8,900 acres in the Horse Heaven Hills area of Benton County. According to the terms of the bequest this land must remain in agricultural use, and KPHD desires to maximize its revenues by leasing the 5,592 acres that have been determined irrigable. *Per the*

1                   *bequest, KPHD will split lease revenues with the*  
2                   *University of Puget Sound.*

3 (SF ¶ 47 (emphasis added).) When the Yakima Nation appealed the ROE,  
4 KPHD's Chief Executive Officer reiterated and confirmed, in a sworn  
5 declaration, that KPHD held the Ayers Property in trust and that the water rights  
6 were to benefit the trust's beneficiaries:

7                   Pursuant to a bequest, *KPHD holds certain real property*  
8                   *in trust, the beneficiaries of which are Kennewick Public*  
9                   *Hospital District and the University of Puget Sound.* The  
10                  bequest restricts the use of the real property to  
11                  agriculture. ... Surface water application S4-30584 was  
12                  made by KPHD *to develop the trust lands* to make  
13                  irrigated agricultural products such as wine grapes and  
14                  soft fruit sustainable.

15 (JSF ¶ 48 (emphasis added).) Then, in 2013, KPHD reiterated unambiguously to  
16 the government that all of the sale proceeds—including water right proceeds—are  
17 subject to the trust. KPHD Commissioner Victor Johnson advised the  
18 Department of Energy on September 16, 2013 that the sale proceeds

19                  are to be divided between the [Kennewick Public  
20                  Hospital] District and University of Puget Sound, half  
                  and half. *The pending sale amount is over \$7 million*  
                  *giving roughly \$3.5 million to each of the recipients."*

(JSF ¶ 62 (emphasis added).) The "over \$7 million" figure referenced the  
proceeds from the sale of both the land and water rights.

1 Thus, the parties agreed, stated, and recognized that the benefits and  
2 proceeds from the water-rights permit, once obtained, would be shared equally by  
3 the University and KPHD as co-beneficiaries of the trust.

4 **B. KPHD Sells Portions of the Ayers Property and Keeps All of the**  
5 **Proceeds for Itself**

6 The State of Washington granted the rights to irrigate certain parcels of the  
7 Ayers Property and, in 2014, KPHD sold those parcels to Easterday Farms. (JSF  
8 ¶¶ 12, 55, 64.) KPHD received \$7,377,000 from the Easterday sale. (JSF ¶ 13.)  
9 Also in 2014, KPHD sold two other small parcels of the Ayers Property to Mark  
10 Bauder for a total of \$34,500. (JSF ¶ 14.)

11 Contrary to the trust provisions in the Ayers' wills, KPHD did not  
12 distribute any of the proceeds from the Easterday or Bauder sales to the  
13 University; nor even did it tell the University that the sales had happened. (JSF  
14 ¶¶ 12, 15.) More than that, KPHD took affirmative steps to mislead the  
15 University. (See JSF ¶¶ 63–72.) Initially, for example, KPHD provided the  
16 University with a draft of the Easterday sale agreement that stated one sale price  
17 covering both the land and the related water rights (JSF ¶¶ 55–57), but it then  
18 secretly split the amounts and concealed that split from the University. (JSF  
19 ¶¶ 66–68.) Then, in response to direct inquiries from the University, KPHD  
20 advised that the sale was delayed when actually it had closed. (JSF ¶¶ 70–72.)

1 The reason for the deceit: by 2014, KPHD had run into financial difficulties,  
2 apparently from the significant debt incurred to build a new hospital. (JSF ¶ 73.)  
3 KPHD used the Easterday and Bauder proceeds to pay its creditors. (JSF ¶ 74.)

#### 4 **C. The Settlement Agreement and Its Amendment**

5 When the University learned that KPHD had secretly sold trust property  
6 and kept all of the proceeds, it demanded that KPHD account for the retained  
7 proceeds and threatened to file suit. (JSF ¶ 16.) The parties agreed to mediate the  
8 dispute. (JSF ¶ 17.) That mediation, which took place in October 2015, lasted 10  
9 hours. (*Id.*) The parties failed to reach agreement that day, but thereafter  
10 continued to negotiate with the assistance of the mediator. (JSF ¶ 18.) The  
11 negotiations were arm's-length and hard-fought, as confirmed by the undisputed  
12 testimony of the lawyer who represented KPHD at the time. (JSF ¶¶ 75, 76.) The  
13 parties finally reached agreement at the end of January 2016, which KPHD's  
14 board approved on February 25, 2016. (JSF ¶¶ 19, 20.)

15 The Settlement Agreement remedied KPHD's breaches by (1) effecting a  
16 true-up of KPHD's trust obligations and (2) clarifying those obligations to ensure  
17 no further breaches.<sup>2</sup> The Settlement Agreement, among other things, provided  
18 that KPHD, as legal title-holder, would sell the remaining trust property—the

---

19 <sup>2</sup> The Settlement Agreement is Exhibit Q to the First Mondou Declaration.  
20

1 portion of the Ayers Property that it did not sell in 2014—and that all of the  
2 proceeds from the sale would be delivered directly to the University out of  
3 escrow. (Settlement Agreement ¶ 5(c).) If the net proceeds were more than the  
4 amounts due the University to repay the diverted funds, the surplus would be  
5 split—the University agreed to deliver funds beyond that which it was due under  
6 the trust back to KPHD. (*Id.* ¶ 5(c)(iv).) The Settlement Agreement thus effected  
7 the wills’ requirement that the University receive a one-half interest in the  
8 proceeds from the Easterday and Bauder sales (and from all trust proceeds).

9       Fifteen months after entering into the Settlement Agreement, KPHD ceased  
10 monthly payments due to the University. (JSF ¶ 22.) KPHD still held legal title  
11 to the remaining Ayers Property and still had the obligation to sell it so that its  
12 beneficiary, the University, could receive the proceeds. KPHD was unable,  
13 however, to market and sell the remaining Property appropriately. (JSF ¶ 77.)

14       The parties therefore agreed to amend the Settlement Agreement to enable  
15 the sale of the remaining Ayers Property and the distribution of the proceeds, so  
16 that the University could receive the one-half share of the total trust proceeds to  
17 which it is entitled. (JSF ¶ 25.) The Amendment allows for the University to  
18 relieve KPHD from the burden of marketing and selling the remaining Ayers  
19  
20

1 Property, and set forth how the costs incurred by the University would be  
2 allocated.<sup>3</sup> (Amendment ¶¶ 1–4.)

3 Alternatively, the Amendment allowed the University to take title to the  
4 remaining Ayers Property. (Amendment ¶ 5.) If it did so, the University was  
5 required to obtain three property valuations for the remaining Ayers Property,  
6 and pay to KPHD any “Excess Transfer Value.” (*Id.* ¶ 6.) This amount is  
7 defined as the difference (if positive) between 50% (representing KPHD’s  
8 beneficial interest in the Ayers Property) of 90% of the average of the three  
9 valuations,<sup>4</sup> minus the “KPHD Obligation Amounts”: (i) the balance of the  
10 withheld proceeds from the Easterday and Bauder sales, and interest thereon;  
11 (ii) the University’s expenses incurred in marketing and selling the remaining  
12 Ayers Property; (iii) KPHD’s share of the closing costs incurred in transferring  
13 the Ayers Property to the University; (iv) estimated closing costs in connection  
14 with the University’s anticipated sale of the remaining Ayers Property; and

---

15 <sup>3</sup> The Amendment is Exhibit S to the First Mondou Declaration.

16 <sup>4</sup> A state statute requires that a public hospital district sell its surplus real estate  
17 for no less than 90% of the average of three appraisals conducted within a year of  
18 the sale. RCW 70.44.300. The parties agreed that this represented the “Fair  
19 Value” of the Property.  
20

1 (v) the University's one-half share of any non-sale proceeds of the Ayers  
2 Property that KPHD had failed to distribute to the University (if any).<sup>5</sup> (*Id.* ¶ 6.)  
3 If such difference were negative, there would be a "Transfer Value Deficiency."  
4 an amount due the University to remedy the fund diversion which cannot be  
5 satisfied from the remaining trust property because its value is insufficient. (*Id.*  
6 ¶ 6(h).)

7 By this time, the parties were cooperating in good faith to carry out  
8 obligations imposed decades before. (JSF ¶ 78.) Thus, KPHD kept the  
9 University apprised regarding its financial situation and the possibility of its filing  
10 for bankruptcy. (*Id.*) On June 28, 2017, the University sent KPHD notice of its  
11 election to exercise the option to acquire the remaining Ayers Property. (JSF

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12 <sup>5</sup> The University's reply in support of its motion for approval of transfer of real  
13 estate held in trust explains in more detail the "KPHD Obligation Amounts"  
14 under the Amendment. (Case No. 17-02025-9, ECF No. 396 at 26–29.) Upon  
15 resolution of the issues presented by this motion, only two issues will remain in  
16 this proceeding: whether and if so in what amount the prevailing party is entitled  
17 to an award of attorneys' fees and costs; and an accounting of the trust property  
18 rents and income received by KPHD since the Settlement Agreement but which  
19 have not to date been shared.  
20

¶ 26.) The University and KPHD executed the documents to convey the remaining Ayers Property; those documents were deposited to escrow on June 30, 2017. (JSF ¶ 28.) The escrow transaction, however, never closed.

**D. KPHD’s Bankruptcy, this Adversary Proceeding, and the Court’s Summary Judgment Order**

KPHD filed its Chapter 9 bankruptcy petition later in the day on June 30, 2017. (Case No. 17-02025-9, ECF No. 1.) KPHD commenced this adversary proceeding by filing a complaint on November 3, 2017. (Case No. 17-80042-FPC9, ECF No. 1.) KPHD later filed an amended complaint (ECF No. 56), to which the University responded by filing an answer and counterclaim (ECF No. 80). In January 2019, both the University and the Liquidation Trust—which was substituted for KPHD—moved for summary judgment. (ECF Nos. 100, 101.) After hearing argument the Court denied the Liquidation Trust’s motion and granted in part the University’s. (ECF No. 126, hereafter the “Order.”)

In its Order, the Court found that the Ayers’ wills created a testamentary trust and that the Ayers Property is the corpus of that trust (*Id.* at 11, ¶ 9); and accordingly concluded that the Ayers Property is not “property of the debtor” in this Chapter 9 bankruptcy proceeding (*see id.* at 10, ¶ 2, reciting the rule that “[p]roperty that a debtor holds in trust for the benefit of another is not ‘property of the debtor’”). The Court further determined that, contrary to the Liquidation

1 Trust's argument, "[t]he Trust was not terminated by the Settlement Agreement"  
2 (*id.* at 11, ¶ 10), and "[t]he Settlement Agreement contains no terms that can be  
3 reasonably construed to provide the Hospital with exclusive ownership of the  
4 Ayers Property" (*id.* at 12, ¶ 16). The Court thus concluded that "[t]he Hospital  
5 holds the Ayers Property in trust, and the University's beneficial interest in the  
6 property continues to exist." (*Id.* at 12, ¶ 17.) It is undisputed, as the Court has  
7 found, that the University's beneficial interest extends to 50% of all proceeds  
8 derived from the Ayers Property. (*Id.* at 2, ¶ 5; *id.* at 11, ¶ 12.)

9 In light of its findings and conclusions, the Court denied the Liquidation  
10 Trust's motion for summary judgment and granted the University's as to the first  
11 three of the amended complaint's claims for relief, which the Court dismissed.  
12 (*Id.* at 12–13, ¶¶ 1, 2.) The Court declined to rule, however, on the University's  
13 motion to the extent it concerned the amended complaint's fifth, seventh, and  
14 ninth claims for relief; that is, the avoidance and preference claims regarding the  
15 payments KPHD had made pursuant to the Settlement Agreement. These issues  
16 are no longer before the Court. The parties have stipulated to their dismissal as  
17 part of a partial settlement of several of the remaining claims, which resolved all  
18 fraudulent transfer, preference and other avoidance claims (in addition to the  
19 dismissal of certain claims by the University). (ECF No. 137.)  
20

1 **E. Unbeknownst to the University, KPHD Transferred to the Liquidation**  
2 **Trust Title to the Ayers Property**

3 In December 2018, before the first motions for summary judgment were  
4 briefed and unbeknownst to the University, KPHD transferred the remaining  
5 Ayers Property to the Liquidation Trust by quitclaim deed. (Declaration of Miles  
6 A. Yanick, dated April 26, 2019 (hereafter “Yanick Decl.”), ¶ 2 & Ex. 1.) This  
7 transfer was in direct violation of the Court’s Plan Confirmation Order. (Case  
8 No. 17-02025-FPC9, ECF No. 981, at 33 (ordering that “the Ayers Property shall  
9 not be transferred by deed or otherwise except as subject to and as ordered in the  
10 UPS Adversary Proceeding”). No one provided any notice of this transaction to  
11 the University, and no one at the University knew this was happening. (Yanick  
12 Decl. ¶¶ 3–4.)

13 **III. ARGUMENT**

14 **A. The Parties’ Current Interests in the Remaining Ayers Property Are**  
15 **Determined by the Law of Trusts**

16 Under the law of trusts, an equitable charge against KPHD’s beneficial  
17 interest in the remaining Ayers Property arose as a matter of law when KPHD  
18 breached its duties as trustee by withholding from the University its share of the  
19 proceeds from the Easterday and Bauder sales. That charge attaches against  
20 KPHD’s beneficial interest upon KPHD’s defalcation, to the extent necessary to  
remedy KPHD’s breach of duty. This hornbook rule ensures, to the extent

possible, that when the last trust asset is sold, KPHD and the University will each have received their one-half beneficial interest over the entire life of the trust.

When confronted with its wrongdoing, KPHD negotiated a settlement with the University that compromised the amount of KPHD's liability, and recited their remaining trust interests and how proceeds would be allocated such that each party receives its one-half share of the total proceeds. As the Court concluded in its summary judgment Order, the Settlement Agreement did not end the parties' trust relationship and replace it with that of a creditor and debtor; instead KPHD's trustee/fiduciary relationship with University as beneficiary remains to this day. (Order at 12, ¶ 17.) Consistent with this relationship and the Ayers' wills, the Settlement Agreement reflects the parties' agreement regarding each of their interests in the remaining trust property to ensure that each ultimately receives its one-half share of trust proceeds, net of costs—as mandated by the Ayers' wills and the law of trusts.

**1. The law of trusts imposes a charge against the beneficial interest of a trustee-beneficiary who has committed a breach of trust.**

As trustee, KPHD had a fiduciary duty to distribute one-half of the net proceeds from the Easterday and Bauder sales to the University—a duty it

1 breached.<sup>6</sup> Thus, under the Washington law of trusts, KPHD's beneficial interest  
2 is applied to make up for the misappropriated and diverted distributions.

3 It is well established that when a trustee who is also a beneficiary commits  
4 a breach of trust, the trustee's beneficial interest will be applied to remedy that  
5 breach. BOGERT'S TRUSTS & TRUSTEES states the rule:

6 If a beneficiary is also a trustee of his own trust, acting  
7 for himself and others, as trustee he owes the  
8 beneficiaries a duty to perform the trust and not to violate  
9 it. If he steals trust funds or causes damage to the trust  
10 estate in other ways, *his share under the trust, whether in*  
11 *his own hands or those of a transferee, will be taken by*  
*the court in order to make good the loss.* If the  
defaulting trustee-beneficiary has stolen... trust income,  
*income later due him may be applied first to the*  
*restoration of lost income due other beneficiaries....*

12 Shapo, et al., BOGERT'S TRUSTS & TRUSTEES § 191 (West, June 2018 update)  
13 (emphasis added); *see also id.* n.18 (collecting cases).

14 Likewise, the RESTATEMENT (SECOND) OF TRUSTS states that “[i]f a trustee  
15 who is also one of the beneficiaries commits a breach of trust, the other

16 <sup>6</sup> The evidence of this breach is both extensive and undisputed, if and to the  
17 extent the Court deems it necessary to so determine. (*See* Section II.B above  
18 from the Statement of Facts, at pp. 8–9, and citations to the record therein; and  
19 Section III.A.6 below at pp. 34–38, and the law and facts cited there.  
20

1 beneficiaries are entitled to *a charge upon his beneficial interest* to secure their  
2 claims against him for the breach of trust.” RESTATEMENT (SECOND) OF TRUSTS  
3 § 257 (1959) (emphasis added) (hereafter “RESTATEMENT (SECOND)”); *see also*  
4 RESTATEMENT (THIRD) OF TRUSTS § 104 & cmt. h (2003) (hereinafter  
5 “RESTATEMENT (THIRD)”) (“If a beneficiary is personally liable to the trust” for  
6 participating in a breach of trust, “the trust is entitled... to a charge against the  
7 beneficiary’s interest in the trust to secure the payment of the liability.”).<sup>7</sup>

8 In short, an aggrieved co-beneficiary is made whole by having its  
9 allocation of what remains of the trust *res* increased, while the offending trustee-  
10 beneficiary’s allocation is correspondingly decreased, such that all of the  
11 beneficiaries ultimately receive, in fact, the distributions dictated by their  
12 respective beneficial interests. The Restatement illustrates it this way:

13 A bequeaths \$30,000 to B in trust for B, C and D in equal  
14 shares. B misappropriates \$5000 of the trust property.  
15 C and D are each entitled to \$10,000 and B is entitled to  
\$5000 out of the trust property.

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16 <sup>7</sup> Washington courts look to both of the RESTATEMENT OF TRUSTS as persuasive  
17 authority. *In re Breast Cancer Prev’n Fund*, 574 B.R. 193, 216 (Bankr. W.D.  
18 Wash. 2017); *see also In re Wash. Builders Benefit Tr.*, 173 Wn. App. 34, 73  
19 (2013) (citing and relying on both the Second and Third Restatements).

1 RESTATEMENT (SECOND) § 257 ill. 3. In the illustration, after B’s breach of trust,  
2 each of C and D have a 40% interest in the remaining trust *res* (\$10,000 of the  
3 remaining \$25,000), so that A’s intent can be carried out and each of B, C, and D  
4 ultimately receive their one-third beneficial interest of the total. Notably, the  
5 Restatement’s illustration states that the co-beneficiaries receive “out of the trust  
6 property” what they should always have received. The trust *res* itself puts them  
7 in the position they would have been in but for the trustee-beneficiary’s breach of  
8 trust—they do not have to look solely to the trustee-beneficiary’s own assets for  
9 relief.

10 Washington follows this rule. In *In re Jackson’s Estate*, 200 Wn. 116  
11 (1939), the executor of an estate, who was also a devisee under the will, had  
12 incurred a debt to the estate, and the Supreme Court affirmed the trial court’s  
13 holding that both the executor’s fees and his share in the estate should be applied  
14 to pay off the debt. The Court held: “Where the executor or administrator of an  
15 estate is its debtor, the amount of his indebtedness is to be retained out of his  
16 distributive share....” *Id.* at 118. The Supreme Court in *Jackson’s Estate* relied  
17 on an Oregon case, *Stanley v. U.S. Nat’l Bank of Portland*, 110 Or. 468 (1924).  
18 See *Jackson’s Estate*, 200 Wn. at 119.

19 In *Stanley*, the decedent had left timber land to his descendants and  
20 appointed one of his sons, who was also a devisee under the will, as executor.

1 The executor made none of the distributions called for by the decedent's will,  
2 "except those made to himself," and he "wasted and misappropriated a large  
3 portion of the estate." *Id.* at 651-52. The Oregon Supreme Court held that "[t]he  
4 right to retain a legacy or distributive share from a debtor to the estate exists in  
5 the case of an indebtedness to the estate arising out of the conversion, waste, or  
6 misapplication of assets by a legatee or distributee while acting in the capacity of  
7 executor or administrator." *Id.* 658. Because the executor's liability for his  
8 breach of trust was "in excess of the value of his share of the estate," the court  
9 held that the executor's rights in the estate "have been satisfied, and in equity  
10 such satisfaction operates to extinguish his title to the remaining property of the  
11 estate." *Id.* at 664.

12 Notably, the court in *Stanley* relied upon cases involving trustees who were  
13 also beneficiaries. In disposing of a claim by the executor's judgment creditor to  
14 the executor's share of the estate, the court quoted the English case *Doering v.*  
15 *Doering*, [1889] 42 Ch. Div. 203, for the proposition that the trustee in this  
16 situation is treated "as having received his share by anticipation, and the answer  
17 to any claim made by the trustee is this: 'You have already received your share;  
18 you have it in your own hands;' and his assignee is in no better position."

19 *Stanley*, 110 Or. at 664 (quotation marks omitted). In turn, both the

20 RESTATEMENT (SECOND) and BOGERT'S TRUSTS & TRUSTEES cite *Stanley* for the

1 proposition that “[i]f a trustee who is one of the beneficiaries commits a breach of  
2 trust, the other beneficiaries are entitled to a charge upon his beneficial interest to  
3 secure their claims against him for the breach of trust.” RESTATEMENT (SECOND)  
4 § 257 reporter’s notes; *see also* BOGERT’S TRUSTS & TRUSTEES § 191 n.18.

5 Under the rule set forth in *Jackson’s Estate* and *Stanley*—as well as in the  
6 RESTATEMENT and BOGERT’S—KPHD’s beneficial interest in the Ayers Property  
7 is “charged,” “retained,” and “impounded” to the extent necessary to distribute to  
8 the University the proceeds from the Ayers Property it would have received but  
9 for KPHD’s breach of trust.

10 **2. The equitable charge on KPHD’s beneficial interest arose**  
11 **immediately, and as a matter of law.**

12 The charge upon KPHD’s beneficial interest, and the reallocation of that  
13 interest to the extent necessary, occurred immediately upon its breach of trust.

14 In the case *In re Van Nostrand’s Will*, 29 N.Y.S.2d 857 (N.Y. Sur. Ct.  
15 1941), it was discovered after the death of a testamentary trust’s trustee-  
16 beneficiary that he had taken funds from the trust in an amount greater than his  
17 beneficial interest. *Id.* at 862. Nevertheless, his successors-in-interest claimed  
18 his beneficial interest in the trust. *Id.* at 863. The court was not sympathetic,  
19 stating that “the position that a defaulting and embezzling fiduciary or those  
20 claiming through him, may receive a distribution of assets of an estate which he

1 has so grievously wronged and to which there has been a minimum of restitution  
2 appears fundamentally opposed to the most primary principles of equity.” *Id.*

3 The court then held “that *immediately* upon the making of the defalcations  
4 an equitable lien was impressed upon any rights or interests which [the trustee-  
5 beneficiary] possessed in the estate and that these were in effect *forthwith*  
6 appropriated by equity for the purpose of accomplishing partial restitution of his  
7 misappropriations.” *Id.* at 865 (emphasis added). Likewise, here, upon KPHD’s  
8 breach of trust its equitable interest was immediately charged with the amount  
9 necessary to make the University whole, and that amount was allocated by equity  
10 to the University’s share.

11 There are several reasons why such an allocation is unaffected by the  
12 subsequent bankruptcy of the breaching trustee-beneficiary. We address two.  
13 First, the charge is against trust property that is not “property of the debtor” for  
14 purposes of bankruptcy law or proceedings. Thus, the equitable charge re-  
15 allocated interests in an asset that is outside this bankruptcy proceeding.

16 Second, as shown just above, the Restatement states that the charge against  
17 the trustee’s beneficial interest is “to secure” the co-beneficiaries’ claims.

18 RESTATEMENT (SECOND) § 257. An official comment explains:

19 The creditors of the trustee-beneficiary stand in no better  
20 position than that in which he stands, and the charge of  
the other beneficiaries upon the interest of the trustee-

beneficiary can be enforced, although his creditors have brought a proceeding to reach his interest and apply it to the satisfaction of their claims.

*Id.* cmt. b.

Either way, the University's charge remedy comes directly from the Ayers Property, not from KPHD's own assets, BOGERT'S TRUSTS & TRUSTEES § 191, and thus is not affected by KPHD's bankruptcy, *In re Unicom Computer Corp.*, 13 F.3d 321, 324 (9th Cir. 1994). And if the charge against KPHD's beneficial interest exceeds the value of that interest, KPHD's interest is extinguished. *Jackson's Estate*, 200 Wn. at 119, citing *Stanley*, 110 Or. 648. This what the law of trusts requires. Nothing in the Settlement Agreement or its Amendment is contrary to this. The opposite is true: those agreements are fully consistent with these rules and requirements, because they require and accomplish the true-up of beneficial interests that the law requires.

**3. The parties' settlement is consistent with trust law: it trues up the trust interests and provides for an immediate reallocation of the interests in the remaining Ayers Property.**

The Ayers' wills mandate that the net proceeds from the Ayers Property be divided equally between the University and KPHD, 50-50. KPHD breached its fiduciary duty as trustee by keeping for itself all of the proceeds from the Easterday and Bauder sales. Rather than defend those claims, KPHD negotiated

1 and reached a settlement with the University, which included agreement as to  
2 each party's going-forward interest in the remaining Ayers Property.

3 The Liquidation Trust has argued that whatever trust rights the University  
4 once had as a beneficiary, the Settlement Agreement erased and replaced them  
5 with only the rights of an unsecured creditor. (*E.g.*, ECF No. 116 at pp. 3, 6, 7 &  
6 16.) The Court rejected this argument, and concluded that the trust continues to  
7 exist, that the remaining Ayers Property is its *res*, and that KPHD remains as  
8 trustee and the University as beneficiary. (Order at 12, ¶¶ 16–17.) The  
9 Liquidation Trust continues, nonetheless, to make essentially the same argument  
10 it made before, and which was rejected: that the Court should now ignore the  
11 equitable charge against the Ayers Property, and should conclude instead that the  
12 University is simply an unsecured creditor against the assets of KPHD (which do  
13 not include the Ayers Property) in regard to the University's recovery of the trust  
14 funds stolen by KPHD.

15 This argument fails here just as it failed in the first round of summary  
16 judgment motions. There is neither factual nor legal basis for an allegation that  
17 the University waived the continued existence of the trust, and thus no basis for  
18 an argument that the University waived the applicability of the law of trusts.

1                   **a. The University's remedy comes from the trust itself, as**  
2                   **contemplated under trust law.**

3                   This adversary proceeding is about interests in the remaining trust property,  
4                   and how to divvy the proceeds of the sale of this real estate. While the University  
5                   has an unsecured claim here to the extent it is unable to recover its full beneficial  
6                   interest in the trust property, that claim is not what this adversary proceeding is  
7                   about. This action is about the remaining Ayers Property—which is not the  
8                   debtor's property under the rulings the Court has already made—and about  
9                   entitlement to the proceeds of its sale.

10                  The provisions at issue in the Settlement Agreement provide that the  
11                  remaining trust property shall be sold and the entirety of the proceeds from that  
12                  sale delivered directly to the University, with the requirement that the University  
13                  remit to KPHD proceeds (if any) that exceed one-half of the total sale proceeds  
14                  minus the balance of withheld proceeds and interest thereon. (Settlement  
15                  Agreement ¶ 5(c).) These provisions provide that, upon the sale of the remaining  
16                  trust property, each beneficiary will have received its correct half-share of the  
17                  total Ayers Property proceeds—just what the law of trusts requires (to the extent  
18                  the value of this property is sufficient to make the University whole). The  
19                  University and KPHD thus put in a writing the very remedy provided for by  
20                  *Jackson's Estate, Stanley*, the RESTATEMENT, and BOGERT'S. *See Jackson's*

1 *Estate*, 200 Wn. at 118; *Stanley*, 110 Or. at 658; RESTATEMENT (SECOND) § 257;  
2 BOGERT’S TRUSTS & TRUSTEES § 191.

3       The Settlement Agreement sets forth the parties’ interests in the trust *res*  
4 itself, by effecting a reallocation of KPHD’s and the University’s rights with  
5 regard to the *remaining* Ayers Property, to remedy the fund diversion. *See Van*  
6 *Nostrand’s Will*, 29 N.Y.S.2d at 865; *see also In re Craig*, 144 F.3d 593, 596 (8th  
7 Cir. 1998) (debtor’s pre-petition performance of obligation renders agreement  
8 non-executory); *Sundstrom v. Sundstrom*, 15 Wn.2d 103, 108 (1942) (equitable  
9 assignment of interest is present transfer). KPHD and the University’s respective  
10 beneficial interests in the Ayers Property remained unchanged: each still had (and  
11 has) a right to 50% of the ***total*** proceeds from the Property. But because KPHD  
12 distributed over \$3.7 million to itself that it should have distributed to the  
13 University, the Settlement Agreement allocated to the University the right to ***all***  
14 proceeds from future sales of the remaining Ayers Property, with a duty to remit  
15 to KPHD one-half of these proceeds minus the balance of withheld proceeds and  
16 interest thereon.

17       Under these provisions, the University’s remedy comes from the trust  
18 itself—that is, ***not*** from “property of the debtor.”  
19  
20

1                   **b. Putting the University’s remedy in writing does not**  
2                   **exempt it from the rules of trust law.**

3                   That KPHD and the University recited their interests in the remaining  
4                   Ayers Property as part of a settlement agreement does not take their relationship  
5                   out of the world of trusts. There is no reason why (and no authority holding that)  
6                   a trustee and a beneficiary cannot settle their claims, and put in writing the  
7                   mechanism by which the trustee’s breach of trust is remedied, without  
8                   transforming their relationship into that of a debtor and creditor.

9                   In fact, the authority is to the contrary. As we addressed in the University’s  
10                  prior motion, a written agreement can recite trust rights and obligations without  
11                  transforming the trustee-beneficiary relationship into one of a debtor and creditor.  
12                  (ECF No. 118, at 9–11); *see also* RESTATEMENT (THIRD) § 95 cmt. a (“Even a  
13                  trustee’s express agreement to perform the duties of the trusteeship does not make  
14                  those duties enforceable in an action at law.”).

15                  This is especially true where, as here, the arrangement the trustee and  
16                  beneficiary put in writing carries out the grantors’ intent and the remedial scheme  
17                  contemplated by the law of trusts. To hold that making such a writing destroys a  
18                  beneficiary’s rights, remedies, and protections under established trust law and  
19                  replaces them with the claim of a general creditor would discourage beneficiaries  
20                  from settling disputes with their trustees. Because “Washington law strongly

1 favors the public policy of settlement over litigation,” the Court should avoid this  
2 outcome and enforce the Settlement Agreement. *Am. Safety Cas. Ins. Co. v. City*  
3 *of Olympia*, 162 Wn.2d 762, 772 (2007) (en banc).

4 **c. The result of the interests in the remaining**  
5 **Ayers Property.**

6 Under the Settlement Agreement, KPHD was obligated to pay to the  
7 University \$3,216,632.48 (\$3.2 million for withheld sale-proceeds distributions,  
8 the balance for withheld operating-proceeds distributions). KPHD paid  
9 \$1,016,632.48 of this amount immediately. KPHD then made further payments  
10 amounting to \$645,682.89, of which \$160,623.07 paid accrued interest and  
11 \$485,059.88 paid down the principal due. Therefore, the principal balance of the  
12 equitable charge today is \$1,714,940.18. Pursuant to the law of trusts and as set  
13 forth in the Settlement Agreement, KPHD’s one-half beneficial interest in the  
14 remaining Ayers Property—whatever dollar amount that may be after the  
15 Property is sold—has been reduced by that amount, and the University’s  
16 correspondingly increased.

17 **4. The Amendment provides for the disposition of the Ayers Property.**

18 Like the Settlement Agreement, the Amendment carries out the Ayers’  
19 intent as expressed in their wills. And like the Settlement Agreement, the  
20 Amendment should be read and applied in light of applicable trust law.

1 KPHD and the University agreed to the Amendment because KPHD had  
2 become unable to perform its duties as trustee. At the time, KPHD still held  
3 legal title to the remaining Ayers Property and still had the obligation to sell it so  
4 that its beneficiary, the University, could receive the proceeds. But its financial  
5 situation rendered KPHD unable to market and sell the remaining Property.

6 Thus, among other things, the Amendment provides that upon written  
7 notice the University may require KPHD to transfer title to the remaining Ayers  
8 Property to the University. (Amendment ¶ 5.) The University exercised this  
9 right, and KPHD and the University executed the documents necessary to  
10 transfer title to the University and deposited them in escrow.

11 **a. The Amendment furthers the Ayers' intent.**

12 The Amendment's provision allowing transfer of title from KPHD to the  
13 University furthers the intent expressed in the Ayers' wills and the requirements  
14 of the law of trusts, in at least two ways. First, it allows title to be placed in the  
15 hands of the party with the ability and the willingness to market and sell the  
16 Ayers Property.

17 Second, it maintains the remedial framework established by the law of  
18 trusts and implemented by the Settlement Agreement. Consistent with its  
19 beneficial interest in the Ayers Property as stated in the wills, the Amendment  
20 states that "'KPHD's Property Valuation Share' is fifty percent (50%) of the Fair

1 Value” of the remaining Ayers Property. (*Id.* ¶ 6(c).) The Amendment further  
2 provides that KPHD is entitled to its Property Valuation Share to the extent that  
3 amount exceeds its Obligation Amounts, including the balance of the withheld  
4 proceeds from the Easterday and Bauder sales (and interest thereon) and various  
5 expenses associated with the transfer of title to the University and with selling  
6 the remaining Ayers Property. (*Id.* ¶ 6(d), (f), (g).)

7 To the extent KPHD’s Property Valuation Share does not exceed these  
8 amounts, then its beneficial interest in the Ayers Property is extinguished as a  
9 matter of law. *Jackson’s Estate*, 200 Wn. at 119, citing *Stanley*, 110 Or. 648.

10 The Amendment, like the original Settlement Agreement, has as its sole  
11 concern the administration of trust property in conformance with the intent  
12 expressed in the Ayers’ wills and consistently with the law of trusts. Moreover,  
13 KPHD’s obligation, upon the University’s demand, to transfer to the University  
14 title to the remaining Ayers Property should not be affected by KPHD’s  
15 bankruptcy, because the only “property of the debtor” involved is bare legal title  
16 to the remaining Ayers Property, and the debtor “derives no benefit from the  
17 debtor’s ownership, as trustee, of the bare naked legal title to the property.” *In re*  
18 *Jones*, 121 B.R. 122, 124 (Bankr. M.D. Fla. 1990) (lifting stay to allow bank to  
19 foreclose interest in property to which debtor held only legal title).

1                   **b. The result of the Amendment**

2           Following the Amendment, the University performed. To value the  
3 remaining Ayers Property as required by the Amendment, the University obtained  
4 three valuations for the two parcels that comprise the remaining Ayers Property,  
5 one being leased orchard property, and the other range/dry-farm land. (First  
6 Mondou Decl. ¶ 25.) Utilizing the formula in the Amendment, the “Fair Value”  
7 of the remaining Ayers Property, as defined in paragraph 6(b) of the Amendment,  
8 is \$3,641,282. (First Mondou Decl. ¶ 25 & Ex. W; Amendment ¶ 6(a)–(b).)  
9 One-half of this Fair Value is \$1,820,641—this is the “KPHD Property Valuation  
10 Share.” (First Mondou Decl. ¶ 26; *see also* Amendment ¶ 6(c).)

11           This is offset by the “KPHD Obligation Amounts,” including the  
12 \$1,714,940 that KPHD failed to repay, plus costs and interest; these total at least  
13 \$2,173,115—which is \$352,474 more than KPHD’s Property Valuation Share.  
14 (First Mondou Decl. ¶¶ 27, 28 & Ex. X; *see also* Amendment ¶ 6(f).)

15           Because KPHD’s Property Valuation Share is less than its Obligation  
16 Amounts, KPHD’s beneficial interest in the remaining Ayers Property is  
17 extinguished. *Jackson’s Estate*, 200 Wn. at 119, citing *Stanley*, 110 Or. 648.

1           **5. In the alternative, the Settlement Agreement and the Amendment**  
2           **are themselves trust-creating instruments entitled to enforcement.**

3           In the event the Court were to reject the foregoing, and in the alternative,  
4           the Settlement Agreement and the Amendment should be regarded as creating a  
5           new trust. As set forth in the University's first motion for summary judgment and  
6           opposition to the Liquidation Trust's motion for summary judgment, the  
7           relationship between KPHD and the University described in the Settlement  
8           Agreement meets all of the requirements of a trust relationship between a trustee  
9           and a beneficiary. (ECF No. 101, at 30–32; ECF No. 115, at 21–23.)

10           To summarize briefly: a trust exists under Washington law when a person  
11           has or accepts property “with the express or implied understanding that he is not  
12           to hold it as his own absolute property, but to hold and apply it for certain  
13           specified purposes.” *Wash. Builders*, 173 Wn. App. at 58, quoting *Westview*  
14           *Invs., Ltd. v. U.S. Bank Nat’l Ass’n*, 133 Wn. App. 835, 845–46 (2006). Pursuant  
15           to the Settlement Agreement, the legal title holder of the Ayers Property, KPHD,  
16           undertook to (a) share with the University one-half of the proceeds from the  
17           operation of the Ayers Property and (b) market and sell that Property, with the  
18           proceeds to go directly to the University out of escrow, as outlined above.  
19           (Settlement Agreement ¶¶ 4–5.) This is a declaratory trust.

1 Per Washington statute and the common law of trusts, a declaratory trust is  
2 created when a person declares that he or she “holds identifiable property as  
3 trustee.” RCW 11.98.008; *see also* RESTATEMENT (THIRD) § 10(c). By entering  
4 into the Settlement Agreement, KPHD declared that it held the Ayers Property as  
5 trustee by agreeing to “hold and apply it for certain specified purposes;” i.e., for  
6 the University’s benefit. *See Wash. Builders*, 173 Wn. App. at 58; *see also*  
7 RESTATEMENT (THIRD) § 2. The case *In re Capps*, 193 B.R. 955, 960–63 (Bankr.  
8 N.D. Ala. 1995), illustrates the fact that a bilateral settlement agreement can  
9 create a trust if it satisfies the criteria, even where that agreement never once uses  
10 the phrase “in trust.” (ECF No. 101, at 31–32); *see also* *FDIC v. Myhre*, 249 F.2d  
11 887, 890 (9th Cir. 1957); *Gurley v. Lindsley*, 459 F.2d 268 (5th Cir. 1972),  
12 *mandate withdrawn and reissued on other grounds*, 466 F.2d 498; *Klickman v.*  
13 *Klickman*, 51 Or. App. 457, 462 (1981); *State ex rel. Knight Oil Co. v. Verdeman*,  
14 409 S.W.2d 672, 676 (Mo. 1966); *Powell v. Parks*, 126 Tex. 338, 342 (1935).

15 Whether the Court treats the Settlement Agreement and its Amendment as  
16 instruments that reflect the remedial provisions of the underlying law of trusts and  
17 carry out the Ayers’ intent expressed in their wills, or as trust-creating  
18 instruments in their own right, the outcome is the same: those agreements should  
19 be enforced according to their terms, regardless of KPHD’s subsequent  
20 bankruptcy.

1                   **6. The University’s claim for a charge against KPHD’s beneficial**  
2                   **interest in the remaining Ayers Property is incontrovertible.**

3                   KPHD’s arm’s-length assent to the Settlement Agreement renders  
4 unnecessary any need to assess the University’s claim for breach of fiduciary  
5 duty. But, in the event the Court were to deem it necessary to confirm the  
6 University’s entitlement to its equitable charge against KPHD’s beneficial interest  
7 in the remaining Ayers Property, the evidence of a breach of duty is  
8 overwhelming and, moreover, undisputed.

9                   As trustee, KPHD owed fiduciary duties to the trust’s beneficiary, the  
10 University. Those include the duty to “administer the trust solely in the interests  
11 of the beneficiaries.” RCW 11.98.078(1); *see also* RESTATEMENT (THIRD)  
12 § 78(1). Therefore, a trustee “is strictly prohibited from engaging in transactions  
13 that involve self-dealing.” RESTATEMENT (THIRD) § 78(2). In keeping for itself  
14 all proceeds from the Easterday and Bauder sales, KPHD breached its duty of  
15 loyalty to the University.

16                   The Liquidation Trust has argued—as did KPHD in 2015—that the water  
17 rights which were part of this sale are personal property not appurtenant to the  
18 land, and therefore that such rights, and proceeds from their sale, are not subject  
19 to the trust or the mandate of the Ayers’ wills. (*See* Am. Complaint ¶¶ 8.5,  
20

1 10.5.) But whether the permit was appurtenant to the land is irrelevant, for at  
2 least three reasons.

3 *First*, the rents derived from the land also were personal property not  
4 appurtenant to the land, but they had to be shared—and in fact were shared in a  
5 clear course of dealing—because the wills expressly provide that *all proceeds*  
6 *from the Ayers Property* must be shared. The wills are thus clear that the  
7 characterization of such proceeds (whether as real property or personal property)  
8 is irrelevant; the wills provide that all proceeds are to be shared.

9 Indeed, KPHD deducted costs associated with seeking the water rights  
10 from the gross proceeds of the Ayers Property, reducing the net proceeds shared  
11 with the University, and included these costs in its accounting of trusts expenses.  
12 (*E.g.*, First Mondou Decl. Ex. E.) In other words, the University's beneficial  
13 interest has been charged with costs incurred by KPHD in seeking water rights,  
14 demonstrating plainly that such rights belong to the trust.

15 *Second*, regardless of its status as real or personal property, the water  
16 permit was obtained through pursuit of an opportunity that belonged to the trust,  
17 making it a violation of the trustee's fiduciary duty to keep the resulting proceeds.  
18 It is undisputed, for example, that without its legal title to the Ayers Property that  
19 it held in trust, KPHD could not have applied for or obtained the water rights.  
20

1            *Grynberg v. Watt*, 717 F.2d 1316, 1317 (10th Cir. 1983) illustrates the  
2 point. There, two co-trustees applied for mining rights through a lottery system  
3 on behalf of themselves individually and the trust they managed. Applying basic  
4 trust principles from the RESTATEMENT (SECOND), the Court of Appeals held that  
5 the trustees violated their duty of loyalty by submitting their own applications and  
6 thus putting themselves in potential conflict with the trust:

7            If one of the trustees had obtained a place ahead of the  
8 trust in the drawing, he or she would have been in a  
9 position of direct conflict with the trust; in essence it was  
10 usurping an opportunity from the trust. The trustee  
11 would be unable to take the lease without breaching his  
12 or her fiduciary duty to the trust.

13            *Id.* at 1319. Thus, “[h]ad either trustee won the lease, he or she *would have held*  
14 *it in trust* for the beneficiary” of the trust. *Id.* (emphasis added); *see also Renz v.*  
15 *Beeman*, 589 F.2d 735, 745–48 (2d Cir. 1978) (“The trust possessed an intangible  
16 asset which was to be free of competition from its fiduciary.... To upset the  
17 balance of control for selfish gain is to commit a breach of the high fiduciary duty  
18 of undivided loyalty.”).

19            *Third*, a trustee may not manage a trust in a manner that benefits itself at  
20 the expense of beneficiaries. RCW 11.98.078(8); RESTATEMENT (THIRD) § 78  
cmt. d; *see also id.* § 86 cmt. c.2. Had KPHD obtained but not sold the water  
rights, the rents for the irrigated Ayers Property would have increased

1 significantly, for the benefit of both beneficiaries. This was the parties' original  
2 plan when obtaining the water rights was first explored. As a fiduciary, KPHD  
3 was not allowed to trade away that mutual benefit for its own gain.

4 Thus, for KPHD to keep the proceeds was a breach of its duty of undivided  
5 loyalty to "act impartially... giving due regard to the beneficiaries' respective  
6 interests." RCW 11.98.078(8); see also RESTATEMENT (SECOND) § 170, cmts. k, l  
7 & p. The opportunity to enhance the value of the land by obtaining that permit  
8 belonged to the trust. Just as with the mining rights sought by the trustees in  
9 *Grynberg*, for KPHD to obtain the water rights solely for itself usurped the trust's  
10 opportunity, in breach of KPHD's fiduciary duty to the University.

11 *Fourth*, KPHD further breached its fiduciary duty to the University by  
12 concealing the fact that the Easterday sale had closed and that KPHD was not  
13 sharing the proceeds with the University. Regardless of whether it acts "in a  
14 fiduciary or personal capacity, a trustee has a duty in dealing with a beneficiary to  
15 deal fairly and to communicate to the beneficiary all material facts the trustee  
16 knows or should know in connection with the matter." RESTATEMENT (THIRD)  
17 § 78(3). There is no question that KPHD had a duty to disclose material  
18 information about the administration of the Ayers Property, and the undisputed  
19 facts show a violation of that duty.  
20

1           *Finally*, the University’s reliance on KPHD’s assurances that it would  
2 share the water-rights proceeds estopped KPHD from taking a contrary position  
3 when it eventually received the proceeds. *See Liebergesell v. Evans*, 93 Wn.2d  
4 881, 888 (1980).

5           Each of these grounds provides independent support for a meritorious  
6 claim that KPHD breached its fiduciary duty, subjecting its beneficial interest in  
7 the remaining Ayers Property to a charge in favor of the University.

8       **B.    The Remaining Ayers Property Should Be Transferred to the**  
9       **University.**

10           **1. The contemplated escrow transaction is no longer possible.**

11           As contemplated by the Amendment, the University and KPHD executed a  
12 statutory warranty deed and other documents transferring to the University legal  
13 title to the Ayers Property, and deposited those documents in escrow. The  
14 Liquidation Trust refers to these documents and this escrow as the “Escrow  
15 Transaction.” (Am. Complaint ¶¶ 3.40–3.43 & 7.2.) The University had sought  
16 the Court’s permission to close that transaction, but now any such relief is  
17 impossible. Because of actions by both KPHD and the Liquidation Trust since  
18 plan confirmation, the Escrow Transaction now simply cannot close.

19           The Escrow Transaction, and the documents that comprise it, contemplate a  
20 transfer of the remaining Ayers Property from KPHD to the University. (First

1 Mondou Decl. Ex. V.) Precisely because the status of and the rights in the Ayers  
2 Property were at issue in this proceeding, the terms of the Plan Confirmation  
3 Order were amended at the confirmation hearing, expressly *to preclude any*  
4 *transfer* of the Ayers Property except as ordered by the Court in this adversary  
5 case. (Case No. 17-02025-FPC9, ECF No. 981, at p. 33 (ordering that “the Ayers  
6 Property shall not be transferred by deed or otherwise except as subject to and as  
7 ordered in the UPS Adversary Proceeding”).)

8 Notwithstanding this order, KPHD and the Liquidation Trust arranged for  
9 the transfer of the parcels comprising the remaining Ayers Property to the  
10 Liquidation Trust by quitclaim deeds. They accomplished this transfer on or  
11 about December 3, 2018. As of today, in violation of the Confirmation Order,  
12 title is held by the Liquidation Trust. No one provided any notice of this  
13 transaction to the University (or to the Court so far as we can tell), and no one at  
14 the University knew this was happening. To the contrary, the University  
15 suspected something was amiss only upon receipt of the pending Motion for  
16 Order Compelling the Debtor to Comply with Its Plan of Adjustment (Case  
17 No. 17-02025-FPC9, ECF No. 1242), which prompted our inquiry by its  
18 reference to property transfers. (Yanick Decl. ¶ 4 & Ex. 2.)

19 As a result of KPHD’s and the Liquidation Trust’s disregard of the Court’s  
20 order, the Escrow Transaction now has been mooted: obviously KPHD cannot

1 transfer title to the University if it has already transferred title to someone else.  
2 Nor would a re-conveyance back to KPHD now allow the Escrow Transaction to  
3 proceed: all of the documents would need to be re-created, with new dates, to  
4 eliminate title uncertainties caused by the intervening, unauthorized transfer to the  
5 Liquidation Trust.<sup>8</sup>

6 **2. The Court should order a transfer in accordance with the**  
7 **Amendment, so that each beneficiary obtains its beneficial interest**  
8 **as the Ayers intended.**

9 Given that the Escrow Transaction now cannot close, the University  
10 requests that Court direct that the terms of the Settlement Agreement, as  
11 amended, be enforced and that the transfer of title to the Ayers Property to the  
12 University as contemplated by the Amendment allowed and ordered.

13 The Settlement Agreement, its Amendment, and the transactions they  
14 contemplate put into practice the underlying law of trusts and carry out the intent  
15 expressed by the Ayers' wills. The remaining Ayers Property is not "property of  
16 the debtor," and those agreements provided for the disposition of the sale

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17 <sup>8</sup> The University reserves all rights and remedies arising from or relating to the  
18 unauthorized transfer in violation of the Court's order (except its claim to close  
19 the Escrow Transaction, which is now not possible and which claim is disposed  
20 of in the partial settlement stipulation, ECF No. 137).

1 proceeds in accordance with each beneficiary's interest. The terms of the  
2 Settlement Agreement, as amended, should thus be enforced and the transfer to  
3 the University of title to the Ayers Property as contemplated by the Amendment  
4 allowed and ordered.

5 Were the Court to conclude there are grounds to decline to enforce the  
6 transfer of property as set forth in the Amendment, the question of who should  
7 sell the trust Property, and under what guidelines and procedures, would remain  
8 and would need to be decided. As of now, KPHD remains the trustee of the trust.  
9 It has never been relieved of that responsibility.

10 If the Court were to determine that it will not allow and order the transfer  
11 as the parties agreed in the Amendment, the Court may exercise its power as a  
12 court in equity to order that a sale or other transfer take place in a manner that  
13 ensures the distribution of sale proceeds consistently with the beneficiaries'  
14 respective remaining interests in the property, on such terms, guidelines and  
15 procedures which the Court deems equitable and just. *Hough v. Stockbridge*, 150  
16 Wn.2d 234, 236 (2003) ("Sitting in equity, a court 'may fashion broad remedies  
17 to do substantial justice to the parties and put an end to litigation,'" quoting  
18 *Carpenter v. Folkerts*, 29 Wn. App. 73, 78 (1981).)

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#### IV. CONCLUSION

For the foregoing reasons, the University respectfully requests that the Court approve the transfer of the remaining Ayers Property to the University as contemplated by the Amendment to the Settlement Agreement.

DATED: April 26, 2019.

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1 **CERTIFICATE OF SERVICE**

2 The undersigned hereby certifies that on April 26, 2019 I electronically  
3 filed the foregoing document with the Clerk of Court using the CM/ECF system  
4 which will send notification of such filing to all counsel of record.

5 I declare under penalty of perjury under the laws of the United States of  
6 America that the foregoing is true and correct.

7 DATED this 26th day of April, 2019 at Seattle, Washington.

8   
9 Gabriella Sanders